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BUSINESS SET. SUN.
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ZAYRE Annual Report 1967

Financial Highlights

	<i>1967</i>	<i>1966</i>
Net Sales	\$402,169,491	\$345,702,887
Net Income	8,132,716	8,109,612
Working Capital	41,471,924	34,010,160
Shareholders' Equity	45,475,715	36,790,164
Net Income Per Common Share	2.76	2.81

Contents

President's Message to Shareholders	
Report of Operations	3
Ten Year Summary of Progress	6
What Zayre Sells	8
Listing — Zayre Corp. Stores	13
Balance Sheet — Zayre and Operating Subsidiaries	14
Balance Sheet — Zayre and All Subsidiaries	15
Statement of Income and Retained Earnings	16
Statement of Funds	17
Directors and Officers	20

COVER

No other event symbolizes the mood of Zayre better than the opening of the huge new distribution center and executive offices in Framingham, Massachusetts during May 1967. Its size, equipment, location and most importantly — its people, all reflect the drive and determination of Zayre to continue its growth pattern.

To Our Shareholders:

1967 was a year of solid accomplishment. Zayre greatly increased its penetration of the many marketing areas it serves and substantially expanded and strengthened its field and central management as well as its facilities to serve its present and future requirements.

Total sales (excluding those of leased departments) rose to \$402,169,491 during the fiscal year ended January 27, 1968, an increase of 16.3% from \$345,702,887 in the prior year.

Net income was \$8,132,716, up slightly from \$8,109,612 in 1966. The 1967 after-tax income represents a 21% return on average shareholders' equity.

Reflecting the somewhat larger number of shares outstanding, earnings per share were \$2.76, down slightly from \$2.81 last year. Earnings, which had lagged during the first part of the year, recovered sharply in the fourth quarter from \$1.31 per share last year to \$1.68 this year. (See financial review on page 3.)

Despite a 16.3% increase, our 1967 sales were not up to expectations. Unusually severe weather plagued volume during the Easter and Spring seasons. Uncertainties in the world at large, including such major problems as the war in Viet Nam, inflation, the civil rights turmoil, and the possibility of higher taxes created a mood of consumer buying restraint. A sharp rise in the rate of savings resulted, which absorbed much of the consumers' growing spending power. Consequently, the

nation's over-all retail sales grew by only some 3%—the smallest annual increase since 1961.

In common with most businesses, Zayre experienced increased operating expenses in response to inflationary pressures and the increase in federal minimum wage levels. During 1967 we also absorbed the first full year's operating expenses associated with the increased field and central management organization and the much enlarged distribution facilities. The costs associated with these programs will bear a better relationship to sales as volume grows during 1968 and 1969.

Retailing is subject to many variables, including national economic trends and consumer attitudes, all of which are difficult to forecast in advance with precise accuracy. Successful retailers must be alert to changing conditions and prepared to take prompt corrective action. As the events of the year unfolded, vigorous action was taken to improve margins, especially through a tightening of inventory controls, and to contain payroll and other operating expenses in line with sales experience. These continuing programs contributed greatly to the improved results in the latter part of the year.

Zayre continues to place great emphasis on expansion. The potential for our industry continues to be most favorable. During the past decade, self-service discount retailing has achieved great consumer acceptance and now accounts for a major portion of over-all

retail sales of general merchandise. We anticipate continued future growth for the national economy and, in particular, for the large suburban areas surrounding major cities which form our primary markets. For some years ahead we see a continued availability of desirable new store sites as well as future sales growth in established units. Accordingly, we believe self-service general merchandising will continue to increase its share of the total market and thus outpace the growth of retailing in general.

Our real estate department has been geared to develop 15 to 20 new Zayre sites per year. This program is being accommodated within our present capital structure and is keyed to our development of management personnel and supporting staff, systems and distribution facilities. During 1967 we opened 19 new Zayre stores and, as previously reported, acquired four Shoppers' City stores. For 1968 we have scheduled 16 to 18 new Zayre units, four of which were opened during March in time for Easter business. 1969 openings will continue at this level or higher.

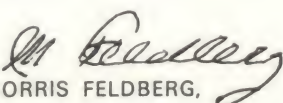
The uncertainties of 1967 continue into 1968. All retailers face another major rise in operating expenses associated with the further increase in

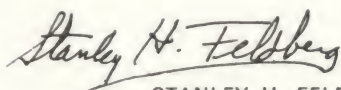
federal minimum wage levels and continued inflation. The mood of restraint on the part of the consumer may well continue for some time to come. However, no further increase in the rate of savings is foreseen. Accordingly, most economists look for a strong rate of growth in retail sales during 1968, substantially above that which prevailed last year. Our own sales experience to date has been much stronger than in 1967 and bears this out.

In an even more positive vein, the economists point out that as the uncertainties in the world-at-large become somewhat better resolved, the American consumer will return to his normal spending pattern, which would mark the beginning of a major further upsurge in retail sales. Accordingly, we are confident that Zayre Corp. will continue to move forward in both volume and earnings over the periods ahead.

Ours is a business of people, and today the Zayre family of employees exceeds 14,000. Their loyalty, diligence, and wholehearted efforts are the Company's principal assets. The directors wish to express sincere appreciation to the Company's employees, and at the same time thank our shareholders and suppliers for their continued confidence.

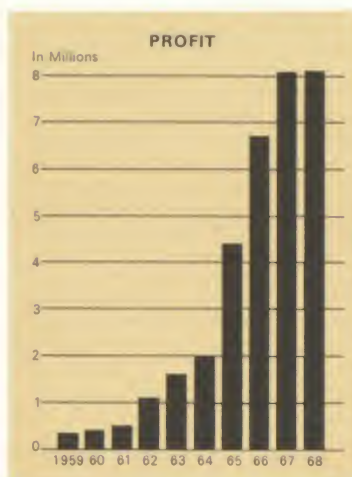
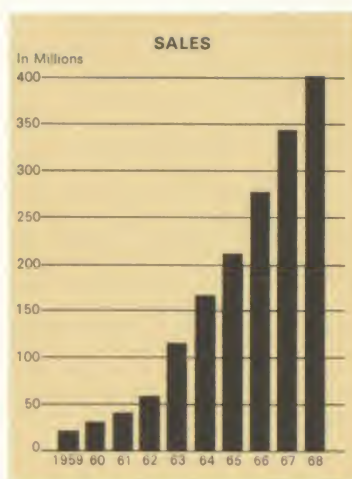
Respectfully submitted,


MORRIS FELDBERG,
Chairman


STANLEY H. FELDBERG,
President

April 17, 1968

Report of Operations



Financial Review

During the fiscal year ended January 27, 1968 volume rose 16.3% to \$402,169,491 from \$345,702,887 in the prior year. Comparative quarterly sales results were:

1967		
Quarter	Sales	% of Total
First	\$ 73,237,880	18.2%
Second	96,013,745	23.9
Third	101,482,125	25.2
Fourth	131,435,741	32.7
	<u>\$402,169,491</u>	<u>100.0%</u>

1966		
Quarter	Sales	% of Total
First	\$ 64,114,734	18.5%
Second	82,623,683	23.9
Third	85,918,707	24.9
Fourth	113,045,763	32.7
	<u>\$345,702,887</u>	<u>100.0%</u>

Per share earnings amounted to \$2.76 in 1967 compared with \$2.81 in 1966. Net income per common share is based on the average number of shares outstanding in each period, after dividend provision for the outstanding shares of preferred stock (including those as to which dividends were waived until after January 29, 1968.)

Comparative earnings by quarters and earnings per share were:

1967		
Quarter	Earnings	Per Share
First	\$ 215,698	\$.05
Second	1,257,302	.42
Third	1,835,365	.61
Fourth	4,824,351	1.68
	<u>\$8,132,716</u>	<u>\$2.76</u>

1966		
Quarter	Earnings	Per Share
First	\$ 773,623	\$.25
Second	1,642,190	.56
Third	1,991,213	.69
Fourth	3,702,586	1.31
	<u>\$8,109,612</u>	<u>\$2.81</u>

As reflected in the Consolidated Statement of Funds working capital increased by \$7,461,764 and aggregated \$41,471,924 at year end. We have continued our policy of choosing to finance capital additions through the leasing subsidiaries. This policy permits the Company to utilize virtually all of its earnings and capital increments to expand its working capital position in support of its merchandising operations.

The Leasing Subsidiaries

Zayre Leasing Corporation purchased and financed the fixtures for the 19 new Zayre stores opened during 1967, as well as additional fixtures required in older Zayre units and in the four Shoppers' City stores acquired in March, 1967. As a result, Zayre Leasing arranged new long-term financing totaling \$9,500,000 during the past fiscal year. During the same period \$2,800,000 of its outstanding debt was retired.

During the year our realty subsidiaries financed the acquisition of land and buildings totaling \$7,039,000, located in Augusta, Maine; Waterville, Maine; Ashland Avenue, Chicago; Duluth, Minnesota; Elyria, Ohio and the construction of the new Framingham central office building. The realty subsidiaries now own thirteen Zayre store locations.

This program of real estate ownership enables Zayre to achieve somewhat lower rentals, over the life of the property, and to retain for the corporation the residual equity remaining in the property after it has been fully depreciated.

Real Estate and Construction

We have enlarged the capabilities of our real estate and construction de-

partment. This group is responsible for the evaluation and selection of new stores, lease negotiations, store maintenance, renovations, enlargements and fixture purchasing and installation. In addition they develop and manage Zayre Realty store properties.

The capabilities of the department have been expanded to embrace the maintenance of existing stores and the fixturing of new units. Zayre pursues a continuing program of maintaining and improving its store properties. This involves annual upkeep as well as periodic overhauls. Every four to six years each store is redecorated. After eight to twelve years, depending on local conditions, each store is completely updated—all fixtures are improved or repaired, new floor tiles and inside signs installed, interior repainted, as well as store design motif updated. Revitalized in appearance, the store is able to deal with its newer competition.

Other departmental responsibilities include the continuing analysis and design of fixtures. As new types of fixtures are proven in actual use in new units, they may be installed in earlier units. In special situations, where space is available and sales are favorable, store expansions and additions are made.

Merchandising

The Zayre merchandise presentation continues to evolve in response to consumer preferences and our own expanding capabilities. Our basic merchandising objective is to provide the customers with a broad assortment of convenience merchandise geared to suburban needs, all under one roof.

Over the years our merchandise mix has become increasingly oriented to the needs of the typical suburban

shopper. For example, although it wasn't until 1962 that Zayre established its first automotive service center, we now operate 64 such centers. The success of our initial experiment with gas stations in 1966 has led us to expand this department to 13 stores. During 1967 our health and beauty aid and candy departments, which were acquired in 1966, achieved major volume gains, improved profits and expanded the lines of merchandise carried.

Expansion

Zayre continues to seek to achieve major retail penetration of those markets served by our stores. Highlights of the past year's 19-store expansion program were the simultaneous opening of four units in Cleveland during November, 1967, and the addition of three stores to the Chicago area, one of the nation's largest retail markets.

The store opening program has resulted in the development of clusters of stores in a number of major markets including Chicago (13), Boston (12), Miami (11), Cleveland (7), Atlanta (5), Washington, D. C. (5), Indianapolis (4), and Pittsburgh (4). There are 11 other cities in which the Company operates either two or three stores.

The 1968 program calls for 16 to 18 new Zayre units, four of which have already been opened. Openings during the balance of the year will add additional units to Atlanta, Columbus, Washington, D. C. and St. Petersburg. Among the new markets to be entered are the Charlotte—Winston-Salem, North Carolina area with three stores, and upstate New York with two.

Over the years there has been a steady advance in the average Zayre store size

in order to embrace our expanded merchandise mix. Currently, most new stores are either 73,500 or 81,550 square feet in gross area. The 115 stores in operation at fiscal year end had a total gross area of approximately 8,627,000 square feet.

Shoppers' City Division

Since its acquisition on March 31, 1967 Shoppers' City has been operated as a separate division of Zayre. It has continued with the same executive staff and personnel, supplemented by the addition of several key executives from Zayre.

This division operates four very large volume discount department stores in Minneapolis, St. Paul and Duluth, Minnesota. All stores are 120,000 square feet or more in gross area and include a full range of general merchandise as well as company operated discount food supermarkets. Plans have been completed for the construction of a fifth Shoppers' City store in Minneapolis, with the opening scheduled for fall, 1968.

During August, 1967 Zayre assumed the operation of the apparel departments in these stores, all of which were formerly leased to others. We have also improved the fixture arrangements and converted the stores from area registers to a more efficient central checkout operation. These stores continue to be operated, other than these changes, under the Shoppers' City name and with the same format.

Other Developments

The Zayre personalized credit card program was introduced into 43 additional Zayre stores during the year and is now available in 90 stores.

The program has accounted for an increasing percentage of total company volume, and with further development and the passage of time, will produce additional sales.

During 1967 we established our first regional office, located in Miami, and appointed a major executive to the position of regional manager. Early in 1968 our second regional office was established in Chicago. This program is still in the process of development, but over a period of time, it is expected to greatly improve coordination and supervision of the efforts of field and store operating and merchandising personnel within the regions. We should also be able to achieve greater emphasis on expense controls and profit margins, as well as better utilization of our central merchandising staff to serve the particular needs of units in each region.

The continued growth of the Company will require additional distribution facilities. We have activated a special study and coordinating committee to develop plans for locating, designing and constructing these facilities. Our present plans call for the development of three regional warehouses to be fully operational by 1970.

The increasing size and complexity of our operations has created a need for unified direction of our distribution facilities. Accordingly, we recently created and staffed the new position of Director of Distribution Services. This executive has responsibility for the operation of all owned distribution centers, supervision of the traffic department and coordination of public warehouse facilities utilized. We expect, over a period of time, to achieve better logistical support for our operations at reduced cost per unit handled.

The apparel specialty shops division ("Bell Shops" and "Nugents") improved its profit contribution during 1967. Six new units were opened and one unit closed, making a total of 45 apparel stores in operation at year end.

Personnel

During the year a number of major executives in various areas of the business were advanced to officerships in recognition of their contributions to the continued growth of the Company, and in furtherance of our desire to enlarge our professional management team to deal with the increasing complexity of our operation:

Finance and Administration:

Sumner L. Feldberg, Senior Vice President, has over-all corporate responsibility for matters relating to finance, administration and distribution.

Paul Kwasnick, formerly Assistant Treasurer, was elected Treasurer and continues as Vice President.

George Freeman was elected Assistant Vice President — Financial Planning.

Louis Cabrera was elected Assistant Treasurer.

Robert Shedd was elected Assistant Treasurer.

Merchandising:

Burton S. Stern, Senior Vice President, has over-all corporate responsibility for merchandise management.

Theodore Schoenfeld was elected Vice President—Merchandising, formerly Assistant Vice President—Merchandising.

Fred Field, General Manager of our Apparel Specialty Stores, was elected Assistant Vice President—Merchandising.

Samuel J. Greenberg was elected Assistant Vice President—Merchandising.

George Summerell joined the Company during the year and was elected Assistant Vice President—Merchandising.

Arnold Suval was elected Assistant Vice President—Merchandising. Mr. Suval has succeeded Maxwell Goldstein, Vice President—Merchandising, who resigned his position during the year to accept the presidency of another retail chain.

Saul Leibow, Vice President—Housewares, gave up active duties to assume the role of consultant. Mr. Leibow was the co-founder and president of Hardlines Distributors, Inc. which was acquired by Zayre in 1966. Leo Michelson, Vice President—Merchandising and co-founder of Hardlines Distributors, Inc., continues with responsibility for the Housewares division.

Real Estate:

Milton L. Levy, Senior Vice President, has assumed over-all corporate responsibility for real estate, construction and maintenance.

Operations and Advertising:

David Goldman was elected Assistant Vice President—Advertising and Sales Promotion.

Joseph Heffernan was elected Assistant Vice President—Store Operations.

Robert Kenzer was elected Assistant Vice President—Store Personnel.

George Mover was elected Assistant Vice President—Regional Manager.

ZAYRE CORP. AND ALL SUBSIDIARIES

Ten-Year Summary of Progress

Fiscal Year Ended Last Saturday in January	1968	1967	1966	1965
OPERATING DATA: (2)				
Net sales, excluding sales of leased departments	\$402,169,491	\$345,702,887	\$278,558,325	\$211,984,918
Income before federal income taxes	\$ 14,432,716	\$ 14,409,612	\$ 11,656,325	\$ 7,482,061
Net income	\$ 8,132,716	\$ 8,109,612	\$ 6,656,325	\$ 4,369,611
Average number of common shares outstanding	2,823,718	2,764,684	2,502,820	2,483,869
Net income per common share (1)	\$2.76	\$2.81	\$2.53	\$1.63
STORES IN OPERATION: (2)				
Self-service department stores	115	96	83	72
Apparel specialty shops	45	40	41	43
FINANCIAL POSITION: (2)				
Current assets	\$ 80,002,811	\$ 69,970,686	\$ 55,771,000	\$ 36,235,800
Current liabilities	\$ 38,530,887	\$ 35,960,526	\$ 26,742,975	\$ 19,805,734
Working capital	\$ 41,471,924	\$ 34,010,160	\$ 29,028,025	\$ 16,430,066
Shareholders' equity	\$ 45,475,715	\$ 36,790,164	\$ 23,746,510	\$ 14,907,961
Number of common shares outstanding at year end	2,855,633	2,779,548	2,530,137	2,486,740
Equity per common share (3)	\$15.01	\$12.46	\$8.78	\$5.67

1964	1963	1962	1961	1960	1959
\$167,846,772	\$115,850,773	\$59,165,743	\$41,942,064	\$31,372,742	\$22,001,541
\$ 3,252,011	\$ 2,622,428	\$ 2,003,736	\$ 1,062,697	\$ 903,148	\$ 517,338
\$ 1,993,277	\$ 1,561,428	\$ 1,126,736	\$ 541,697	\$ 441,148	\$ 295,338
2,483,450	2,190,766	2,109,100	2,109,100	2,109,100	2,109,100
\$.67	\$.56	\$.53	\$.26	\$.21	\$.14
64	47	27	14	11	6
46	48	52	59	61	64
\$ 33,110,766	\$ 21,891,016	\$11,467,893	<p>(1) Net income per common share is based on the average number of shares outstanding each year as retroactively adjusted for the preferred and common stock issued in connection with "poolings of interests," after pro forma recognition of the full \$347,727 dividend requirements on the shares of preferred stock.</p> <p>(2) Information reflects acquisitions on a "pooling of interests" basis for Shoppers' City, Inc. (1964-1968) and Hardlines Distributors, Inc. (1963-1967).</p> <p>(3) Information assumes full conversion of the 463,636 shares of preferred stock into 173,863 shares of common stock.</p>		
\$ 18,996,036	\$ 12,364,312	\$ 7,347,858			
\$ 14,114,730	\$ 9,526,704	\$ 4,120,035			
\$ 11,694,875	\$ 10,023,589	\$ 4,957,270			
2,483,450	2,354,100	2,109,100			
\$4.38	\$3.93	\$2.35			

What Zayre Sells

Convenience and value are the underlying themes that have led to Zayre's success. Value is reflected in the consistently low prices made possible through the application of self-service principles and volume purchasing. Convenience is emphasized in the many categories of popular priced merchandise brought together in deep assortments within a single store, specially designed to satisfy the suburban shopper's home, apparel and recreational needs.

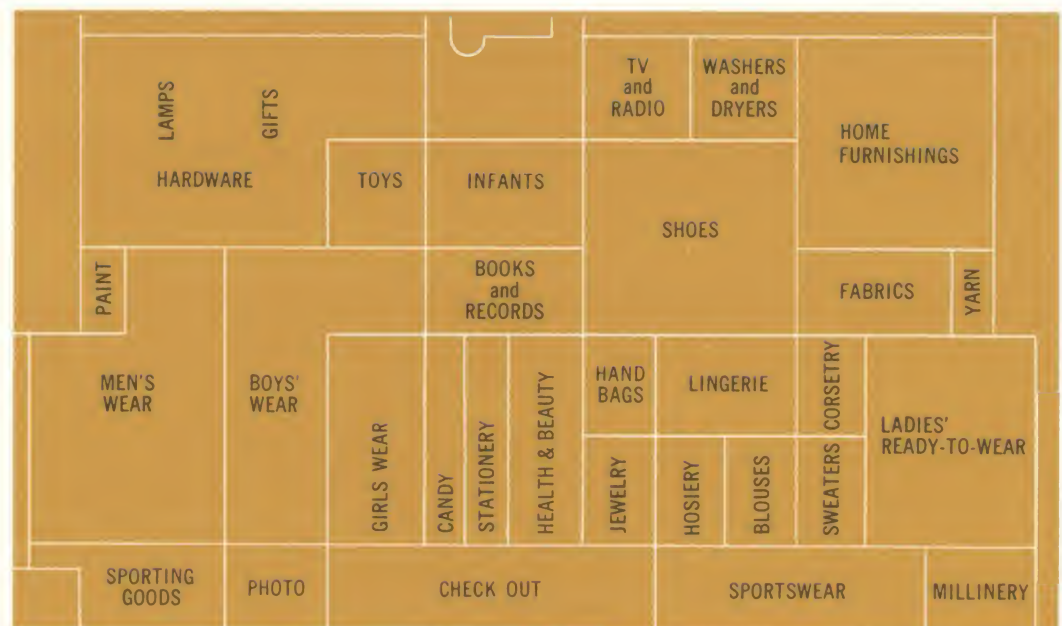
In this age of rapid change and instant communication, fashion is everywhere and constantly evolving. Fashion adds the "sizzle", the flavor, and the excitement to every shopping trip. Fashion is to be found not only in apparel with its many "looks" and the excitement of mini, midi and maxi skirt lengths, but also in that brand new hair spray, that "just-introduced" electric appliance, and the sound of that smash hit teenage record.

Come along on a shopping trip through Zayre. We enter into the many colorful departments that make up Zayre's ladies' and girls' apparel presentation. Apparel and accessories are gathered from New York, California, Miami and other fashion capitals of the world. Zayre rushes the most wanted styles to its stores so that they will be available at the appropriate time to fulfill customer demand.

Continuing our imaginary shopping trip we pass through a colorful "home-maker" section replete with complete assortments of towels, sheets, bedspreads and draperies. Tremendous changes in consumer preference for colors, stripes and patterns have banished the drab white goods look of yesteryear. Our path will take us through a huge shoe department stocked with everything from colorful pumps and flats to comfortable slippers for all members of the family.

Appliance Center - USA offers a

Typical Zayre Store Layout





What Zayre Sells

(Continued)

gleaming array of the most wanted brands of refrigerators, washers, color TV and stereos. The desire of the American consumer for greater convenience has led to the development of a profusion of new products in the small appliance area. Over 50% of the items now on sale have been introduced within the past five years.

A huge toy department fascinates both young and old—not just at Christmas, but throughout the year. Leisure time enthusiasts will find much to excite them in the photography, sporting goods, book and record departments. The do-it-yourself addict with his specialized construction and repair needs as well as the average suburban housewife with her broad range of household, maintenance, kitchen and decorative requirements can





all shop quickly and easily in the many houseware and hardware departments.

Turtlenecks ahead — and we're surrounded by men's and boys' furnishings. Here Zayre accents fashion by supplying the latest styles and colors in shirts, slacks, sportswear and accessories. At the front of the store we find stationery, tempting candy and a vast assortment of drugs, cosmetics and health and beauty needs. Our tour ends at the central checkout lanes where purchases are swiftly tallied and wrapped.

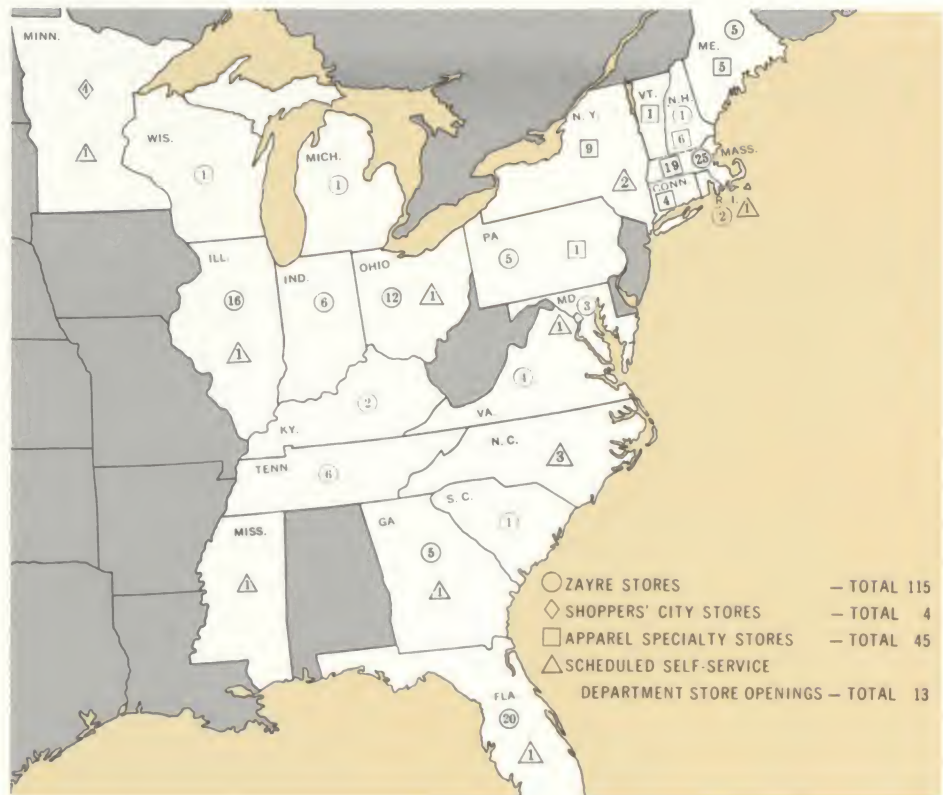


What Zayre Sells

(Continued)

At many Zayre stores customers can arrange for auto repairs or auto accessory installations while they shop. It's all part of the Zayre one-stop shopping concept which puts customer convenience first. Shopping is easy and informal with ready access, free parking, attractive well-lighted stores, open counters, self-selection, credit plans, and convenient 10 A.M. to 10 P.M. shopping hours six days a week. Join millions of other satisfied customers — shop the Zayre store near your home.





Zayre Corp. Stores (In Operation at April 1, 1968)

Zayre Stores (115)

Florida — **JACKSONVILLE** (2) Beach Blvd., Normandy Blvd. — **LARGO** — **MELBOURNE** — **MIAMI** (11) Coral Way, Fort Lauderdale (2), Grove Gate, Hialeah, North Miami Beach, Pompano Beach, 2nd Avenue, 7th Avenue, South Dixie Highway, West Hollywood — **ORLANDO** (2) Lake Howell Road, South Orange Avenue — **TAMPA** (2) East Hillsborough, Gandy Blvd. — **WEST PALM BEACH**

Georgia — **ATLANTA** (5) Buford Highway, Cascade Avenue, Decatur, Smyrna, Stewart Avenue

Illinois — **CHAMPAIGN** — **CHICAGO** (13) Addison, Ashland, Bridgeview, Columbus Avenue, Des Plaines, Forest Park, Joliet, Lombard, Markham, Oaklawn, Palatine, River Grove, 26th and Whipple — **ROCK ISLAND** — **SPRINGFIELD**

Indiana — **HAMMOND** — **INDIANAPOLIS** (4) East 10th Street, North Tibbs Avenue, Pendleton Pike, South East Highway — **MUNCIE**

Kentucky — **LOUISVILLE** (2) Bardstown Road, Dixie Highway

Maine — **AUGUSTA** — **BANGOR** — **PORTLAND** — **PRESQUE ISLE** — **WATERVILLE**

Maryland — **DISTRICT OF COLUMBIA** (3) Lanham, Silver Springs, Wheaton

Massachusetts — **ATTLEBORO** — **BOSTON** (12) Beverly, Braintree, Cambridge, Dorchester, Medford, Natick, Revere, Roslindale, Roxbury, Saugus, Waltham, Woburn — **FALL RIVER** — **GREAT BARRINGTON** — **HADLEY** — **HYANNIS** — **LOWELL** — **METHUEN** — **PITTSFIELD** — **SPRINGFIELD** (3) Agawam, Boston Road, Chicopee — **WORCESTER** (2) Lincoln Street, Stafford Street

Michigan — **KALAMAZOO**

New Hampshire — **MANCHESTER**

Ohio — **CINCINNATI** (3) Paxton Avenue, Princeton Pike, Seymour Avenue — **CLEVELAND** (7) Brook Park, Elyria, Mayfield Heights, Mentor, North Olmsted, Ridge Road, Warrensville Heights — **COLUMBUS** (2) East Main Street, West Broad Street

Pennsylvania — **PITTSBURGH** (4) Baden, McKeesport, McKnight Road, Monroeville — **WILKES-BARRE**

Rhode Island — **PROVIDENCE** (2) East Providence, Silver Spring Street

South Carolina — **COLUMBIA**

Tennessee — **CHATTANOOGA** — **KNOXVILLE** — **MEMPHIS** (2) Poplar Avenue, Summer Avenue — **NASHVILLE** (2) Gallatin Road, Murfreesboro Road

Virginia — **DISTRICT OF COLUMBIA** (2) Alexandria, Falls Church — **PORTSMOUTH** — **RICHMOND**

Wisconsin — **RACINE**

Shoppers' City Stores (4)

Minnesota — **DULUTH** — **MINNEAPOLIS** (2) Brooklyn Center, St. Louis Park — **ST. PAUL**

Apparel Specialty Stores (45)

Connecticut — **MANCHESTER** — **NORWICH** — **THOMPSONVILLE** — **TORRINGTON**

Maine — **AUGUSTA** — **BIDDEFORD** — **LEWISTON** — **PORTLAND** — **SKOWHEGAN**

Massachusetts — **BOSTON** — **DEDHAM** — **DORCHESTER** — **FAIRVIEW** — **FALL RIVER** — **FRAMINGHAM** — **GLOUCESTER** — **HADLEY** — **LAWRENCE** — **LOWELL** — **LYNN** — **MALDEN** — **PITTSFIELD** — **QUINCY** — **SALEM** — **SPRINGFIELD** — **WALTHAM** — **WESTFIELD** — **WORCESTER**

New Hampshire — **BERLIN** — **CONCORD** — **KEENE** — **MANCHESTER** — **NASHUA** — **ROCHESTER**

New York — **AUBURN** — **CANANDAIGUA** — **GLENS FALLS** — **JAMESTOWN** — **KINGSTON** — **NIAGARA FALLS** — **OLEAN** — **POUGHKEEPSIE** — **WATERTOWN**

Pennsylvania — **ERIE**

Vermont — **NEWPORT**

Store Openings Now Scheduled

ZAYRE STORES

Florida — **ST. PETERSBURG**

Georgia — **ATLANTA** (Jonesboro Road)

Illinois — **DANVILLE**

Mississippi — **JACKSON**

New York — **GLENS FALLS** — **JAMESTOWN**

North Carolina — **CHARLOTTE** (2) Eastway, Woodlawn — **WINSTON-SALEM**

Ohio — **COLUMBUS** (Reed & Henderson)

Rhode Island — **PROVIDENCE** (Cranston)

Virginia — **DISTRICT OF COLUMBIA** (Tysons Corner)

SHOPPERS' CITY STORES

Minnesota — **MINNEAPOLIS** (Columbia Heights)

Zayre Corp. and Operating Subsidiaries

CONSOLIDATED BALANCE SHEETS

Assets

	Jan. 27, 1968	Jan. 28, 1967
Current assets:		
Cash	\$ 8,037,164	\$ 6,443,796
U. S. Treasury bills	998,125	2,488,055
Customer instalment receivables	2,128,822	
Accounts receivable, trade and other	3,096,882	3,299,822
Amounts due from vendors	2,702,974	2,462,000
Merchandise inventories, at the lower of cost (retail method) or market	59,734,749	52,802,068
Due from leasing subsidiaries	1,497,860	970,618
Prepaid expenses	1,590,756	1,647,097
Total current assets	<u>79,787,332</u>	<u>70,113,456</u>
Equity in wholly owned unconsolidated leasing subsidiaries (note A)	2,786,968	2,180,402
Equipment and leasehold costs and improvements, at cost	4,960,257	4,696,889
Less accumulated depreciation and amortization	<u>2,319,870</u>	<u>1,923,007</u>
	2,640,387	2,773,882
Preopening expenses, at amortized cost	761,774	562,300
Deferred charges and other assets	1,180,756	1,462,534
	<u>\$87,157,217</u>	<u>\$77,092,574</u>

Liabilities

Current liabilities:		
Current instalments of general corporate debt	\$ 1,120,000	\$ 1,423,693
Accounts payable	22,149,822	20,290,864
Sales taxes, payroll withholdings, and collections for leased departments	3,475,207	1,636,647
Accrued expenses	5,435,135	4,369,204
Federal income taxes (including current portion of deferred)	2,023,397	4,434,262
Total current liabilities	<u>34,203,561</u>	<u>32,154,670</u>
General corporate debt, exclusive of current instalments (note B)	7,082,492	8,021,493
Deferred federal income taxes (note C)	395,449	126,247
Commitments (notes D and E)		

Shareholders' Equity

Preferred stock, par value \$1, authorized 1,000,000 shares		
Series A cumulative convertible preferred stock, issued and outstanding		
463,636 shares (note F)	463,636	463,636
Common stock, par value \$1, authorized 7,000,000 shares, issued and outstanding		
2,855,633 shares (notes F, G and H)	2,855,633	2,779,548
Additional paid-in capital	10,075,119	9,373,369
Retained earnings (notes B and F)	<u>32,081,327</u>	<u>24,173,611</u>
	45,475,715	36,790,164
	<u>\$87,157,217</u>	<u>\$77,092,574</u>

The accompanying notes are an integral part of the financial statements

Zayre Corp. and All Subsidiaries

CONSOLIDATED BALANCE SHEETS

Assets

	Jan. 27, 1968	Jan. 28, 1967
Current assets:		
Cash	\$ 8,848,851	\$ 6,837,902
U. S. Treasury bills	1,814,980	2,883,114
Customer instalment receivables	2,128,822	
Accounts receivable, trade and other	3,181,679	3,338,505
Amounts due from vendors	2,702,974	2,462,000
Merchandise inventories, at the lower of cost (retail method) or market	59,734,749	52,802,068
Prepaid expenses	1,590,756	1,647,097
Total current assets	<u>80,002,811</u>	<u>69,970,686</u>
Property, at cost:		
Land	3,905,412	1,740,430
Buildings	15,426,955	9,280,723
Leasehold costs and improvements	4,988,802	4,451,054
Furniture, fixtures and equipment	33,916,813	25,844,755
	<u>58,237,982</u>	<u>41,316,962</u>
Less accumulated depreciation and amortization	<u>13,654,791</u>	<u>10,194,898</u>
	<u>44,583,191</u>	<u>31,122,064</u>
Preopening expenses, at amortized cost	761,774	562,300
Deferred charges and other assets	1,292,880	1,570,049
	<u>\$126,640,656</u>	<u>\$103,225,099</u>

Liabilities

Current liabilities:		
Current instalments of long-term debt	\$ 4,725,315	\$ 4,191,252
Accounts payable	22,543,749	21,104,342
Sales taxes, payroll withholdings, and collections for leased departments	3,475,207	1,636,647
Accrued expenses	5,654,547	4,585,414
Federal income taxes (including current portion of deferred)	2,132,069	4,442,871
Total current liabilities	<u>38,530,887</u>	<u>35,960,526</u>
Long-term debt, exclusive of current instalments (note B):		
General corporate debt	7,082,492	8,021,493
Equipment promissory notes	17,166,923	11,045,515
Real estate mortgages	16,709,671	10,223,040
Deferred federal income taxes (note C)	1,674,968	1,184,361
Commitments (notes D and E)		

Shareholders' Equity

Preferred stock, par value \$1, authorized 1,000,000 shares		
Series A cumulative convertible preferred stock, issued and outstanding		
463,636 shares (note F)	463,636	463,636
Common stock, par value \$1, authorized 7,000,000 shares, issued and outstanding		
2,855,633 shares (notes F, G and H)	2,855,633	2,779,548
Additional paid-in capital	10,075,119	9,373,369
Retained earnings (notes B and F)	32,081,327	24,173,611
	<u>45,475,715</u>	<u>36,790,164</u>
	<u>\$126,640,656</u>	<u>\$103,225,099</u>

The accompanying notes are an integral part of the financial statements

Zayre Corp. and All Subsidiaries

CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS

Fiscal Year Ended

	<i>Jan. 27, 1968</i>	<i>Jan. 28, 1967</i>
Net sales, excluding sales of leased departments	\$402,169,491	\$345,702,887
Rentals from leased departments, net of estimated allocated store expenses	1,240,060	1,027,932
Other income	529,083	753,696
	<u>403,938,634</u>	<u>347,484,515</u>
Cost of sales, including buying and occupancy costs	322,680,829	280,070,848
Selling, general and administrative expenses	59,225,409	47,403,826
Depreciation and amortization	5,006,888	3,729,729
Interest expense	2,592,792	1,870,500
	<u>389,505,918</u>	<u>333,074,903</u>
Income before provision for federal income taxes	14,432,716	14,409,612
Provision for federal income taxes (note C)	6,300,000	6,300,000
Net income	<u>8,132,716</u>	<u>8,109,612</u>
Retained earnings at beginning of year	24,173,611	16,420,899
Dividends on preferred stock and, in 1967, of pooled companies prior to acquisition (note F)	(225,000)	(356,900)
Retained earnings at end of year	<u>\$ 32,081,327</u>	<u>\$ 24,173,611</u>
Net income per common share (note I)	<u>\$2.76</u>	<u>\$2.81</u>

CONSOLIDATED STATEMENTS OF ADDITIONAL PAID-IN CAPITAL

Balance at beginning of year	\$ 9,373,369	\$ 4,331,838
Excess of net cash proceeds over par value of shares (20,075 in 1968 and 9,940 in 1967) of common stock issued upon exercise of stock options	230,056	97,349
Excess of net cash proceeds over par value of 56,010 shares of common stock issued upon exercise of warrants	327,340	
Other credits (net) arising from pooling (note C)	144,354	25,560
Excess of conversion price over par value of 239,471 shares of common stock issued in exchange for convertible subordinated debentures, net of related unamortized debt expense		5,158,622
Expenses incurred in connection with poolings		(240,000)
Balance at end of year	<u>\$ 10,075,119</u>	<u>\$ 9,373,369</u>

The accompanying notes are an integral part of the financial statements

Zayre Corp. and All Subsidiaries

CONSOLIDATED STATEMENTS OF FUNDS

	Fiscal Year Ended	
Source	Jan. 27, 1968	Jan. 28, 1967
Net income	\$ 8,132,716	\$ 8,109,612
Charges to income not requiring current expenditures of funds:		
Depreciation and amortization	5,006,888	3,729,729
Deferred federal income taxes (excluding current portion)	490,000	276,000
Funds provided from operations	13,629,604	12,115,341
Net increase in long-term debt	11,669,038	3,871,704
Common stock issued upon exercise of options and warrants and upon conversion of debentures	633,481	5,505,382
Tax benefit arising from pooling (note C)	405,000	167,000
	<u>\$ 26,337,123</u>	<u>\$ 21,659,427</u>
Application		
Land and buildings (net additions)	\$ 8,312,491	\$ 2,618,874
Fixtures, equipment and leasehold costs and improvements (net additions)	8,842,394	6,824,958
Preopening costs	1,206,818	759,156
Deferred charges and other assets	288,656	315,933
Dividends, including those of pooled companies prior to acquisition	225,000	356,900
Other		239,471
Redemption of convertible subordinated debentures		5,562,000
	<u>18,875,359</u>	<u>16,677,292</u>
Increase in working capital	7,461,764	4,982,135
	<u>\$ 26,337,123</u>	<u>\$ 21,659,427</u>

The accompanying notes are an integral part of the financial statements

AUDITORS' REPORT

LYBRAND, ROSS BROS. & MONTGOMERY
CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Directors of Zayre Corp.:

We have examined the consolidated balance sheet of Zayre Corp. and All Subsidiaries as of January 27, 1968, the related consolidated statements of income and retained earnings, additional paid-in capital, and funds for the fiscal year then ended, and the consolidated balance sheet of Zayre Corp. and Operating Subsidiaries as of January 27, 1968. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We previously examined and reported upon the financial statements for the fiscal year ended January 28, 1967.

In our opinion, the aforementioned financial statements present fairly the financial position of Zayre Corp. and All Subsidiaries and Zayre Corp. and Operating Subsidiaries at January 27, 1968 and January 28, 1967, and the results of operations and source and application of funds of Zayre Corp. and All Subsidiaries for the fiscal years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Boston, Massachusetts
April 16, 1968

Lybrand, Ross Bros. & Montgomery

Zayre Corp. and All Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A — Basis of Presentation

The consolidated financial statements of Zayre Corp. and All Subsidiaries include the financial statements of all the Company's subsidiaries, all wholly owned. However, the consolidated balance sheet of Zayre Corp. and Operating Subsidiaries excludes the assets and liabilities of the leasing subsidiaries, which are presented in note J.

B — Long-Term Debt

At January 27, 1968, long-term debt, exclusive of current instalments, consisted of the following:

General corporate debt:	
6% promissory note, payable \$60,000 semi-annually, balance due April 1, 1976	\$ 960,000
5.8% promissory notes, payable \$250,000 annually, balance due January 31, 1978	2,500,000
5½% subordinated notes, payable \$200,000 annually, balance due January 15, 1979	2,100,000
Promissory note, ¼% over prime, payable \$75,000 quarterly, balance due March 31, 1972	975,000
6½% promissory note, payable \$75,000 annually, balance due July 1, 1974	450,000
Other	97,492
	<u>7,082,492</u>
Equipment promissory notes, payable \$376,329 monthly including interest (varying in some cases with prime) principally at 5% to 6½% maturing April 1, 1969 to November 1, 1975	17,166,923
Real estate mortgages, payable \$716,457 semi-annually including interest at 5½% to 6½% maturing March 30, 1970 to January 6, 1993	16,709,671
	<u>\$40,959,086</u>

The 5½% subordinated notes are subordinated to the other general corporate debt. Under provisions of the agreements governing long-term debt, \$16,000,000 of retained earnings was available for dividends at January 27, 1968.

While the parent company is not directly obligated with respect to the equipment promissory notes or real estate mortgages,

it has guaranteed the leases which have been assigned as collateral for such debt, and it has also agreed to provide additional financing to the real estate subsidiaries under certain circumstances.

C — Federal Income Taxes

Deferred federal income taxes arise from income tax and financial reporting differences with respect to depreciation expense, pre-opening costs, certain accrued expenses, and customer instalment receivables.

Investment credit used to reduce the provisions for federal income taxes amounted to \$565,000 in fiscal 1968 and \$316,000 in fiscal 1967. Approximately \$56,000 of unused investment credit is available for reduction of future taxes.

Other credits (net) to additional paid-in capital represent the federal income tax benefits resulting from the acquisition ("pooling of interests") of a company in fiscal 1967 after reflecting amortization of the cash portion of the acquisition.

D — Commitments

The companies are committed to pay minimum annual rentals, exclusive of, in many instances, real estate taxes, insurance, maintenance and additional rentals based on sales, under long-term leases expiring: between 1971 and 1978 — \$1,900,000, between 1979 and 1985 — \$5,500,000, and between 1986 and 1994 — \$4,600,000. Additional minimum annual rentals of approximately \$1,500,000 will be payable under long-term leases for stores not yet opened.

The Company has outstanding purchase commitments of approximately \$4,100,000 for real estate and leasehold improvements and \$3,800,000 for furniture, fixtures and equipment for new stores.

E — Retirement Plan

The actuarially determined cost of the Company's noncontributory, funded employee Retirement Plan, amounting to \$530,000 in fiscal 1968 (including amortization of prior service costs over thirty years), and of an unfunded plan, amounting to \$31,000 in fiscal 1968 (including amortization of prior service costs over forty years), has been charged to income.

F — Preferred Stock

The Company's series A cumulative convertible preferred stock is entitled to a liquidation preference of \$16.50 per share, or \$7,649,994 in the aggregate for the 463,636 shares issued and outstanding, and is redeemable, at the option of the Company, at the same price. Each series A preferred share is convertible into .375 shares of common stock through June 30, 1971 and into .359 shares thereafter through June 30, 1975. The Company has reserved 173,863 shares of common stock for issuance upon exercise of the conversion privilege. Dividends were paid at an annual rate of \$.75 per share on 300,000 shares during fiscal 1968 and will begin to accrue for the remaining 163,636 shares on January 30, 1968.

G — Stock Options

Under its Stock Option Plans, the Company has granted certain officers and key employees options for the purchase of common stock within five years from the grant date at option prices of 100% of market price on the grant date. Generally, all options are exercisable in four equal cumulative annual instalments commencing one year after the grant date. Unissued common stock reserved for options aggregated 162,165 shares at January 27, 1968 and 87,710 shares at January 28, 1967.

Information concerning activity during fiscal 1968 follows:

	Option Prices	Number of Common Shares	
		Issuable under Options Granted	Available for Future Options
Outstanding at 1/28/67	\$7.06 to \$37.38	87,440	270
Authorized under 1967 Plan			100,000
Options granted	\$35.13	45,200	(45,200)
Options exercised	\$7.06 to \$34.25	(20,075)	
Cancellations		(5,200)	
Termination of 1965 Plan			(270)
Outstanding at 1/27/68	\$7.06 to \$37.38	<u>107,365</u>	<u>54,800</u>

H — Stock Purchase Warrants

Class A and Class B warrants for the purchase of 52,520 and 31,493 shares, respectively, of the Company's common stock were outstanding at January 27, 1968. The price at which they are exercisable through July 15, 1971 is \$7.14 for Class A warrants and \$8.93 for Class B warrants; thereafter both classes are exercisable at \$10.71 per share until they expire on January 15, 1979. The exercise prices and the number of shares are subject to anti-dilution provisions and adjustment for recapitalizations and similar events. The Company has reserved 84,013 shares of common stock for issuance upon exercise of these warrants. Class A and Class B warrants for the purchase of 35,014 and 20,996 shares, respectively, of common stock were exercised in July, 1967.

Note I — Net Income per Common Share

Net income per common share is based on the average number of shares outstanding after dividend provision for the outstanding

shares of preferred stock (including those as to which dividends were waived until after January 29, 1968). Pro forma net income per common share would have been \$2.63 in fiscal 1968 and \$2.63 in fiscal 1967, assuming full conversion of the outstanding preferred stock and exercise of all outstanding warrants and exercisable stock options.

J — Combined Balance Sheets of the Leasing Subsidiaries

	January 27, 1968	January 28, 1967
ASSETS		
Property, at cost:		
Land and buildings	\$19,332,367	\$11,021,153
Furniture, fixtures, and leasehold improvements	<u>33,945,358</u>	<u>25,598,920</u>
	53,277,725	36,620,073
Less accumulated depreciation and amortization	<u>11,334,921</u>	<u>8,271,891</u>
	41,942,804	28,348,182
Cash and U. S. Treasury bills	1,628,542	789,165
Accounts receivable	84,797	38,683
Other assets	<u>112,124</u>	<u>107,515</u>
	<u>\$43,768,267</u>	<u>\$29,283,545</u>
LIABILITIES		
Long-term debt, including current instalments of \$3,605,315 in 1968 and \$2,767,559 in 1967 (note B)	\$37,481,909	\$24,036,114
Accounts payable and accrued expenses	613,339	1,029,358
Federal income taxes	108,672	8,939
Due to parent and operating subsidiaries	1,497,860	970,618
Deferred federal income taxes	<u>1,279,519</u>	<u>1,058,114</u>
	\$40,981,299	\$27,103,143
EQUITY	<u>2,786,968</u>	<u>2,180,402</u>
	<u>\$43,768,267</u>	<u>\$29,283,545</u>

Fixed annual rentals are payable, under long-term leases, by the parent company and its operating subsidiaries for the use of real estate, furniture, fixtures and leasehold improvements owned by the leasing subsidiaries.



Stanley H. Feldberg, Morris Feldberg, Abram Berkowitz



Burton S. Stern, Walter J. Salmon, Sumner L. Feldberg



Morris Natelson, Milton L. Levy, Max Feldberg, Newton A. Lane

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Chairman

STANLEY H. FELDBERG
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MILTON L. LEVY
Senior Vice President

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Partner, Ropes & Gray

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*Professor of Marketing
Harvard Graduate School of
Business Administration*

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*Vice Chairman and
Executive Vice President*

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Senior Vice President

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Senior Vice President

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Partner, Nathanson & Rudofsky

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Partner, Lehman Brothers

Officers

Senior

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Real Estate*

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*Vice Chairman of the Board and
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Senior Vice President—Finance

BURTON S. STERN
*Senior Vice President—
General Merchandise Manager*

Merchandising

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GEORGE SUMMERELL
Assistant Vice President

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Vice President

THEODORE SCHOENFELD
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ARNOLD SUVAL
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Assistant Treasurer

NORMAN LENOX
*Assistant Vice President and
Assistant Secretary*

NEWTON A. LANE
Secretary

GEORGE FREEMAN
*Assistant Vice President—
Financial Planning*

ROBERT SHEDD
Assistant Treasurer

Operations and Advertising

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Vice President—Store Operations

DAVID GOLDMAN
*Assistant Vice President—
Advertising and Sales Promotion*

ROBERT KENZER
*Assistant Vice President—
Store Personnel*

JOSEPH HEFFERNAN
*Assistant Vice President—
Store Operations*

GEORGE MOVER
*Assistant Vice President—
Regional Manager*

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State Street Bank and Trust Company
Boston, Massachusetts
Irving Trust Company
New York, New York

Common Stock Registrars

The First National Bank of Boston
Boston, Massachusetts
The Chase Manhattan Bank
New York, New York

Preferred Stock Transfer Agent

State Street Bank and Trust Company
Boston, Massachusetts

Common Stock Listing

New York Stock Exchange

General Counsel

Nathanson & Rudofsky

Special Counsel

Ropes & Gray

Auditors

Lybrand, Ross Bros. & Montgomery
Touche, Ross, Bailey & Smart

Distribution Centers

Framingham, Massachusetts
Natick, Massachusetts
New York, New York

Executive Offices

Framingham, Massachusetts

Annual Meeting

The 1968 annual meeting will be held at 11:00 A.M. on Tuesday, June 4, 1968, in the Forum Room, State Street Bank and Trust Company, 225 Franklin Street, Boston, Massachusetts.

